

Message Text

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SUBJECT: GOVERNMENT OUTLINES BUDGET AND PROPOSED TAX REFORMS

REF: A) CERP 200 B) 77 ATHENS 11376 C) 77 ATHENS 11528

D) 77 ATHENS 4762

1. SUMMARY AND COMMENT: BECAUSE OF THE ELECTIONS THIS YEAR, THE BUDGET PRESENTATION TO PARLIAMENT, WHICH USUALLY TAKES PLACE AT THE END OF NOVEMBER, WAS DELAYED. THE FINANCE MINISTER NOW EXPECTS IT TO BE READY BY THE MIDDLE OF JANUARY. IN A POLICY ADDRESS SHORTLY BEFORE CHRISTMAS, HOWEVER, THE COORDINATION AND FINANCE MINISTERS OUTLINED ITS OVERALL MAGNITUDES ALONG WITH PROPOSED TAX REFORM MEASURES. AS PRESAGED IN CARAMANLIS' DECEMBER 14 POLICY SPEECH (REF B), THIS YEAR'S BUDGET WILL BE SOMEWHAT MORE EXPANSIONARY, IN ORDER TO STIMULATE ECONOMIC

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ACTIVITY WHICH SLOWED DRAMATICALLY DURING THE SECOND HALF OF 1977. THE REGULAR BUDGET WILL BE BALANCED AT 250 BILLION DRACHMAS, A 25 PERCENT INCREASE OVER LAST YEAR. THE INVESTMENT BUDGET, WHICH WILL BE ALMOST ENTIRELY DEFICIT FINANCED, IS 22 PERCENT HIGHER THAN IN 1977. IT IS THROUGH THIS SPENDING THAT THE GOVERNMENT HOPES TO MOBILIZE THE LAGGING INVESTMENT SECTOR AND STIMULATE ECONOMIC ACTIVITY, PARTICULARLY INDUSTRIAL PRODUCTION WHICH INCREASED BY

ONLY FOUR PERCENT IN 1977. WE DO NOT YET KNOW THE TOTAL PUBLIC SECTOR CONTRIBUTION TO THE ECONOMY'S LIQUIDITY FOR 1978, BECAUSE IN ADDITION TO ALMOST 55 BILLION FROM THE INVESTMENT BUDGET WILL BE DEFICITS OF THE CONSUMER GOODS ACCOUNT AND THE PUBLIC ENTERPRISES' INVESTMENT SPENDING, WHICH ARE NOT INCLUDED IN THE STATE BUDGET BUT ARE EVENTUALLY FINANCED BY THE GOVERNMENT. ON THING IS CLEAR, HOWEVER, THE PUBLIC SECTOR WILL HAVE BOTH AN EXPANSIONARY AND AN INFLATIONARY IMPACT ON THE ECONOMY IN 1978. END SUMMARY AND COMMENT.

2. 1978 STATE BUDGET: THE 1978 STATE BUDGET PROVIDES FOR A 24 PERCENT INCREASE OVER LAST YEAR'S ACTUAL LEVEL, FROM 245 BILLION DRACHMAS TO 305 BILLION DRACHMS. THIS BRINGS THE BUDGET TO 27 PERCENT OF ESTIMATED GNP AT MARKET PRICES. ASSUMING A DEFLATOR OF AROUND 12 PERCENT, THERE SHOULD BE A 12 PERCENT REAL INCREASE IN GOVERNMENT SPENDING.

3. REGULAR BUDGET EXPENDITURE WILL RISE BY 25 PERCENT, FROM 200 BILLION DRACHMAS TO 250 BILLION, INCLUDING THE UNALLOCATED 10 BILLION DRACHMA RESERVE FUND. ALTHOUGH DETAILS HAVE NOT YET BEEN RELEASED, WE ANTICIPATE THAT DEFENSE EXPENDITURES AND INCREASED SALARIES AND PENSIONS FOR CIVIL SERVANTS WILL ABSORB A SUBSTANTIAL PART OF THE ORDINARY BUDGET INCREASES.

4. THE INVESTMENT BUDGET IS SET AT 55 BILLION DRACHMAS, VIS-A-VIS 45 BILLION DRACHMAS LAST YEAR, A NOMINAL INCREASE LIMITED OFFICIAL USE

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OF 22 PERCENT AND A REAL INCREASE OF AROUND 10 PERCENT. THIS IS INDICATIVE OF A MORE EXPANSIONARY FISCAL POLICY, SINCE DEFICIT-FINANCED INVESTMENT EXPENDITURES ARE THE ONLY PART OF THE BUDGET FLEXIBLE ENOUGH TO BE USED AS A POLICY TOOL. IN RECENT YEARS, PUBLIC INVESTMENT EXPENDITURES HAVE BEEN CURTAILED, BECAUSE OF BOTH THE PRESSING NEED FOR REGULAR BUDGET EXPENDITURES, PARTICULARLY IN THE DEFENSE MINISTRY, AND EFFORTS TO RESTRAIN INFLATION. LAST YEAR ACTUAL INVESTMENT BUDGET EXPENDITURES INCREASED ONLY 13 PERCENT, IN FACT NO INCREASE IN REAL TERMS. THE PUBLIC SECTOR'S SHARE OF GROSS FIXED ASSET FORMATION HAS DECLINED FROM 30 PERCENT IN 1974 TO 27 PERCENT IN 1976.

5. REVENUES: REVENUES ARE PROJECTED TO GROW BY 25 PERCENT AND SHOULD BALANCE THE REGULAR BUDGET AGAIN THIS YEAR. ALTHOUGH DETAILS ON THE SOURCE OF INCREASED REVENUE ARE NOT YET AVAILABLE, THE GOVERNMENT HAS ANNOUNCED THAT NO NEW TAXES WILL BE LEVIED, DEDUCTIONS WILL BE INCREASED, AND MOST OF THE LUXURY TAXES INTRODUCED LAST MAY, WHICH WERE FOUND TO BE INEFFECTUAL, WILL BE ABOLISHED. THUS THE PROJECTED INCREASE IN TAX REVENUE MUST DERIVE FROM A LARGER TAX BASE, AN ACCELERATION IN TRANSACTIONS YIELDING STAMP AND TURNOVER TAX REVENUE, AND HIGHER IMPORTS. IT IS LIKELY THAT INDIRECT TAXES, WHICH ALREADY MAKE UP ABOUT THREE FOURTHS OF THE

TOTAL, WILL RISE AT A FASTER RATE, RESULTING IN AN EVEN MORE REGRESSIVE TAX SYSTEM DESPITE GOG EFFORTS TO PROVIDE RELIEF TO LOWER INCOME CLASSES. MOREOVER, THE GOVERNMENT HAS AGREED TO ABOLISH THE PROPERTY TAX IN 1979, UNLESS THIS LOSS OF REVENUES IS COMPENSATED BY INCREASED DIRECT TAXES, THE PROPORTION OF INDIRECT REVENUE WILL RISE EVEN MORE NEXT YEAR.

6. THE FINANCE MINISTRY ESTIMATES THE PROPOSED REFORMS WILL RESULT IN A LOSS OF 6.5 BILLION DRACHMAS IN REVENUE THIS YEAR. DETAILS OF THE MOST IMPORTANT CHANGES ARE AS FOLLOWS:

- A. THE CEILING FOR NON-TAXABLE INCOME AFTER DEDUCTIONS AND ALLOWANCES WILL BE RAISED FROM 30,000 TO 60,000 DRACHMAS.
 - B. UP TO 60,000 DRACHMAS MAY BE DEDUCTED FROM 1978 SALARY INCOMES (TAXABLE IN 1979), AN INCREASE FROM 40,000 DRACHMAS.
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C. TAX FREE GROSS INCOME OF AGRICULTURAL ENTERPRISES WILL BE DOUBLED, FROM 250,000 DRACHMAS TO 500,000 DRACHMAS, FOR THOSE ENGAGED EXCLUSIVELY IN FARMING.

D. INHERITANCE, DOWRY, AND GIFT TAXES FOR FARMS OF UP TO 40 STREMMAS (4 HECTARES) ARE ABOLISHED IN CERTAIN CASES.

E. LUXURY TAXES IMPOSED IN MAY, 1977 (REF C) ARE ABOLISHED, WITH THE EXCEPTION OF THOSE ON RECREATION AND AUTOMOBILES WITH ENGINES OVER 1800 CC.

F. EVERY TAXPAYER WILL BE ALLOWED A TAX REBATE FOR HIMSELF AND EACH OF HIS DEPENDENTS. THE REBATE WILL AMOUNT TO 1,500 DRACHMAS FOR THE TAXPAYER, SPOUSE AND FIRST TWO CHILDREN, 2,000 FOR THE THIRD AND 2,500 FOR EACH SUBSEQUENT CHILD. FOR OTHER DEPENDENTS THERE WILL BE A 1,000 DRACHMA REBATE. THIS IS PERHAPS THE MOST SIGNIFICANT TAX RELIEF MEASURE.

G. THE TAX ON REAL PROPERTY WILL BE ABOLISHED IN 1979 AND MAY BE SUBSTITUTED WITH ANOTHER TAX, THE REVENUES OF WHICH WILL BE USED FOR TOWN PLANNING AND ENVIRONMENTAL PROTECTION.

7. VIEWS OF THE OPPOSITION: NO UNEXPECTEDLY, THE OPPOSITION PARTIES CRITICIZED THE GOVERNMENT'S PROPOSALS IN PARLIAMENT. PAPANDREOU (PASOK) SAID THEY WERE INADEQUATE, HAPHAZARD, AND LACKING IN COORDINATION. ALTHOUGH HE WELCOMED THE TAX RELIEF MEASURES, HE MAINTAINED THAT INFLATION WILL BE AROUND 15 PERCENT THIS YEAR AND THEREFORE THE GOG ATTEMPT TO HOLD WAGE INCREASES TO THIS LEVEL IS UNFAIR. ZIGDIS (EDHK) CRITICIZED BOTH THE GOG'S POLICIES AND ITS PROPOSED MEASURES TO IMPLEMENT THEM.

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